NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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BANKING REGULATIONS

CFPB's Unconstitutional Structure Did Not Limit Its Authority [10TH CIR]

A payday lender (lender) offered short-term, small-dollar consumer loans at high interest rates. The loan disclosure documents, provided by the lender to consumers, misled the consumers about the terms of the loans. Consumers filed complaints with the Federal Trade Commission. The Consumer Financial Protection Bureau (CFPB) began investigating the lender and its loan practices. The CFPB sent a civil investigative demand (Demand) to the lender to obtain information about the lender's practices and documents. The investigation revealed the loan documents violated federal law and the disclosures misled consumers. The Bureau filed a Notice of Charges against the lender and its C.E.O. During the first hearing, the Bureau enlisted an ALJ to determine the charges. The ALJ held a three-day evidentiary hearing and issued a ruling, which was appealed by the lender to the CFPB's Director. The Director held the appeal pending the Supreme Court's decision in Lucia v. SEC, 138 S. Ct. 2044(2018). That supreme court case decided the administrative law judges were required to be appointed by the President, a court of law, or a department. Because the ALJ enlisted by the CFPB had not been properly appointed, the Director remanded the case to a constitutionally appointed ALJ for a new hearing. The lender requested a new hearing to put on evidence in which it could further develop the record but the new ALJ determined that the previous ALJ had given the parties an adequate opportunity to present their cases and reviewed the ruling de novo. The ALJ recommended that the lender be held liable on all counts and be responsible for equitable restitution. The ALJ also recommended that the C.E.O. be held responsible jointly and severally with the lender. The CFPB Director adopted the ALJ's restitution award and civil penalty recommendations but decreased the amounts of the awards. The lender appealed the Director's final decision, claiming the Bureau's entire enforcement action should be set aside because the CFPB had been unconstitutionally structured when it had filed its charges, relying on Seila Law LLC v. CFPB, 140 S. Ct. 2183, 207 L. Ed. 2d 494 (2020), in which the Supreme Court had held that the requirement the CFPB's Director could only be removed for "cause" was unconstitutional. In addition, the lender argued that the charges had been filed outside the three year statute of limitations period. The lender also argued it had been deprived of due process, specifically addressing the lack of a full new trial. Lastly, the lender argued the Director's restitution award was unlawful because it concerned an equitable remedy that should have taken into consideration the lender's business expenses.

In Integrity Advance, LLC v. Consumer Fin. Prot. Bureau, 48 F.4th 1161 (10th Cir. 2022), the court held that the previously unconstitutional structure of the Consumer Financial Protective Bureau did not result in compensable harm. By the time the decision was made, Congress had revised the statute to allow a CFBP director to be removed without cause. Moreover, the responses from the lender to the complaint had triggered the statute of limitations because it was only with the information in the response that the CFPB had enough information to act. For that reason, the court rejected the argument that the consumer complaint had triggered the statute of limitation. With regard to the request for a new evidentiary hearing, the court explained that there is no bright-line rule prohibiting de novo review of a previous administrative hearing, nor was a new hearing required to be a more extensive hearing. Here, the parties had a full opportunity to present their case in the first proceeding. The court also stated that the lender did not challenge the designation in the Director's order calling for both legal and equitable restitution, and therefore, the challenge to the amount of damages was waived. For that reason, the court evaluated the order as a legal remedy, which is appropriate under 12 U.S.C. § 5565(a)(l), and did not need to include an offset of business expenses in determining damages.

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FDIC Can Determine if Payment is "Golden Parachute" Even Without Exact Dollar Amounts [D.C. CIR]

Bank executives entered into a series of employment agreements with the bank. Under the agreements, the bank had the right to terminate the executives without cause so long as it provided them 60 days' notice. If they were terminated without cause, the executives would be entitled to their most recent base salary for the unexpired term of their employment agreement. But if a change in control of the bank occurred during the term of the employment agreement, such as through a merger, the executives would be entitled to a lump-sum severance payment. The bank later participated in a merger. One of the merger conditions was that the executives would enter into amended employment agreements. The bank later issued notices of termination without cause to the executives. The executives sued the bank's holding company. The bank sought guidance from the FDIC, which held that the monetary relief sought by the executives would constitute a prohibited golden parachute. The executives filed suit in the federal district court, seeking to reverse this determination.

In Bauer v. FDIC, 38 F.4th 1114 (D.C. Cir. 2022), the district court held that the FDIC lacked authority to issue a final decision on the banks' golden parachute application because the decision was "based on hypothetical payments" in an ongoing litigation. The court relied on 12 C.F.R. § 303.244, which states that an application for an FDIC determination "shall contain the cost of the proposed payment and its impact on the institution." Id. § 303.244(c), (c)(4). The court reasoned that this language unambiguously requires that the applicant put forward the planned, actual amount of the golden parachute and does not permit the FDIC to make a determination on a hypothetical payment that arises from an ongoing litigation. The court also added that without a proposed amount, there would be too much unknown in determining liability and monetary damage amounts. Based on its conclusion that the FDIC had acted outside of its authority, the district court vacated the FDIC's final determination as contrary to law. The executives then appealed to the court of appeals for the D.C. circuit. The circuit court determined that the district court erred in holding that the FDIC lacked authority to render its golden parachute determination. The requirement that the application contain the cost of the proposed payment was a requirement for the application, the court of appeals held, and not a limitation on the power of the FDIC. Accordingly, the case was remanded back to the district court to consider the executives claims on the merits.

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BANKRUPTCY

Secured Creditor May Not Spring Surprise Fees on a Debtor After a Claim Has Been Allowed [BK SD GA]

A debtor obtained a loan from a creditor and granted the creditor a security interest in a mobile home. Later, the debtor filed a Chapter 13 case and proposed to make payments on the secured portion of the claim, while the unsecured portion of the claim would be treated as an unsecured claim. The creditor filed a proof of claim with a valuation of the collateral and an interest rate much higher than the debtor's valuation and proposed interest rate. The creditor then objected to confirmation of the debtor's plan, stating that the valuation of the mobile home and the interest rate in the plan were too low. The issues were resolved when the court entered a consent order, resolving the creditor's objection to the plan. The consent order provided for a valuation of the home and the interest rate on the claim. It provided that the amount of the claim that was more than the value of the mobile home would be an unsecured claim. The debtor then moved to confirm her repayment plan with the terms of the consent incorporated in the plan, and the court confirmed the plan. Later, the creditor filed a Notice of Post petition Mortgage Fees, Expenses, and Charges, "ostensibly pursuant to Bankruptcy Rule 3002.l(c) [seeking] the following fees: (l) $475.00 for 'Bankruptcy/ Proof of claim fees' incurred on August 26, 202l; (2) $250.00 for 'Proof of Claim 410A' incurred on August 26, 2021; and (3) $550.00 for 'Objection to Plan' incurred on September 15, 202l, for a total of $1,275.00," to which the debtor responded. In her filing, the debtor requested that the fees proposed by the creditor be entirely disallowed, arguing that the creditor had failed to meet its burden of proof.

In White v. NewRez LLC. (In re White), 64l B.R. 717 (Bankr. S.D. Ga. 2022), the court denied the debtor's motion as moot, barring the parties from taking this claim to a different court to litigate. The court first defined the purpose of Bankruptcy Rule 3002.l, which prevents surprise charges to a claim to arise after the close of the case. The claim at issue was within the scope of Rule 3002.l(a), so the provisions of 3002.l(c)-(e) applied. These provisions provide that the creditor must serve the debtor with a notice of fees, which the creditor had done, and what fees may be recovered. The court agreed with the debtor, who argued that her Chapter 13 plan did not include a provision to pay these additional charges. When a claim is bifurcated and allowed by court order, the court reasoned, the original contract is no longer what binds the parties and the payments provided for in the plan are not pursuant to the prepetlt1on contract. Accordingly, the court held that Bankruptcy Rule 3002.l did not apply to the creditor's claim.

The court next explained that the creditor could not collect from the debtor because the debt had been discharged and if the creditor attempted to collect from the debtor, it's actions would undermine the purpose for which Rule 3002.1 had been created. Finally, the court held that the debtor's motion should be denied as moot because if the court only disallowed the motion, the creditor might try to relitigate the issues in a state court.

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Chapter 13 Debtor Cannot Avoid Unperfected Security Interest [WD WI]

The Chapter 13 debtor had obtained a loan for over $129,000 from the creditor to fund the purchase of a manufactured home. The creditor had received a security interest in the home. The debtor filed for Chapter 13 bankruptcy approximately one year following the transaction. The creditor argued that it was a secured creditor because it held a perfected security interest in the manufactured home. In response, the debtor brought an adversary proceeding against the creditor, seeking to avoid the creditor's security interest. The debtor contended that the manufactured home was a fixture, which required the creditor to have filed a mortgage or a UCC fixture filing, which the creditor had not done. The issue was whether the debtor had the right to bring an adversary proceeding that might allow the debtor to avoid the creditor's security interest. The bankruptcy court agreed with the debtor that the debtor could bring such an action and granted judgment in the debtor's favor.

In 21st Mortg. Corp. v. Warfel, Case No. 22-cv-88-jdp, 2022 WL 17663908, 2022 U.S. Dist. LEXIS 224967 (Dec. 14, 2022) (unpublished opinion), the district court reversed the prior judgment and found the language of 11 U.S.C. § 544(b)(l) to be unambiguous in providing that avoidance rights clearly belong to the trustee. The statute is silent as to any other party having the right to bring avoidance actions. The debtor put forth several arguments, but the court found none of them to be persuasive. The debtor was unable to point to anything in the Bankruptcy Code supporting an interpretation that it grants avoidance rights to a Chapter 13 debtor. The debtor tried to rely on the doctrine of derivative standing. This doctrine allows a party to sue on a trustee's behalf. However, the debtor was unable to show anything in the record indicating that the debtor had asked the bankruptcy court to apply the doctrine. Moreover, while Chapter 11, in 11 U.S.C. § 1107, gives debtors many of the same powers as trustees, Chapter 13 does not include such provisions. Indeed, the court reasoned that it could not ignore the plain language of the statute, which does not give debtors the right to bring an avoidance action. That right, the court emphasized, is strictly left to trustees.

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Court Sanctioned Lawyers and Principal for Bad Faith Bankruptcy Filing [BKR WD TN]

A closely held corporation and its president, the debtor in this case, signed a petition to commence Chapter 11 bankruptcy. A corporation (corporation A) filed a motion to dismiss the debtor's Chapter 11 case. Before the debtor filed, a separate corporation (corporation B) had obtained a judgment against the debtor. Corporation B joined corporation A in the motion to dismiss the debtor's bankruptcy case. After conducting an evidentiary hearing, the court granted the motion to dismiss. The hearing revealed that the only reason given by the debtor for filing the bankruptcy petition was to avoid the posting of an appellate bond to stay collection of corporation B's judgment against the debtor. Upon the granting of the motion to dismiss, corporation A filed a motion for sanctions against the debtor. Corporation A requested the debtor pay $200,000, or another amount as determined by the court, as a sanction for its acts in initiating the bankruptcy case for the improper purpose of avoiding a judgment. Corporation A also asserted that the filing of the bankruptcy petition by the debtor caused corporation A to incur substantial legal fees and expenses. In response, the debtor argued that its conduct was not particularly egregious and therefore necessitated no further sanction. In addition, the debtor argued both that the award of sanctions was not necessary to deter similar conduct by the debtor and that the request was unreasonable because the monetary amount requested was too high.

In Sigma Corp. v. Island Indus. (In re Island Indus.), No. 22-20380-L, 2023 Bankr. LEXIS 384, (Bankr. W.D. Tenn. Feb. 7, 2023) (opinion not yet released for publication), the court held the dismissal of the bankruptcy petition would be insufficient to deter the debtor and similarly situated parties from filing a Chapter 11 bankruptcy instead of posting an appellate bond. To deter future discrepancies and abuse of the bankruptcy process by the attorneys involved, relying on Bankruptcy Rule 9011, the court reduced the fees the attorneys requested for their representation in the bankruptcy case by 25%. The court noted that this reduction could help the debtor pay the judgment it had sought to avoid. The court also determined additional sanctions should be imposed on the president of the debtor corporation because his actions permitted and encouraged his counsel to engage in numerous

tactics to delay the collection of the judgment. During that time, he had engaged in transferring company assets to and for the benefit of himself and other insiders. The court determined the president should pay $50,000 to corporation A as the result of his bad faith actions, which the court believed would serve to deter others similarly situated from pursuing similar activities.

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EMPLOYMENT

Employment Claims are Subject to Arbitration Clause if the Employee Signed the Agreement [TX AP]

Before her employment, an employee of an assisted living facility (the employer) signed a copy of the Employment Dispute Resolution Program (agreement). The agreement provided that the employer and employee would agree to resolve all claims, controversies, or disputes relating to employment or termination through the agreement. Furthermore, after accepting the job offer, the employee signed an acknowledgment form stating that accepting employment constituted the employee's acknowledgment that she was bound by the agreement. The employer later terminated the employee. The employee sued the employer for retaliation under the Texas Health & Safety Code. The employer then moved to arbitrate the employee's claims under the agreement, arguing that the arbitration agreement was valid because, after receiving notice, the employee continued to work for the employer and was thus bound to the arbitration terms. The employee argued that the agreement was invalid because it did not identify the employer, therefore, it failed for indefiniteness. Furthermore, the employee argued that even if the agreement was valid, the employer did not sign it, and thus it was unenforceable against the employee. Finally, the employee argued that the agreement was unenforceable because it contained a confidentiality clause, making it unconscionable.

In SSC Wimberley Operating Co., LLC v. Goodman, 04-22-00355-CV, 2023 WL 150869, Tex. App. LEXIS 140 (Tex. App. Jan. 11, 2023) (opinion not yet released for publication), the court upheld the arbitration agreement finding that it was valid and the employee's retaliation claim was within the scope of the arbitration agreement. The court first evaluated the validity of the arbitration agreement between the employee and the employer. The employee argued that the employer did not establish a valid arbitration agreement because the agreement was between "the employee" and "the Company," and the agreement does not define the company. The court rejected this argument because the agreement established that "the Company" is the employer for which the employee will be working. Other documents also clarified that the company was the employer. For instance, the court relied on the acknowledgment form that the employee signed, on which she had handwritten the name of the facility she would be working. Finally, the court explained that the surrounding circumstances made it clear that the employer referred to itself as "the Company" in the agreement. The court stated that if the employee was uncertain about who the employer was when she signed the agreement, the employee should have asked for clarification. Therefore, there was a valid arbitration agreement between the parties. Next, the court considered whether the employee's claim was within the scope of the arbitration agreement. The court determined that it should decide whether the claim falls within the scope of an arbitration agreement by examining the facts alleged in the plaintiff's (employee) petition and the terms of the agreement. The court held that the plaintiff's retaliation claims regarding the employment and the employee's termination were within the scope of the agreement. The court held this because the agreement provided in relevant part that "The Company and I agree to resolve all claims, controversies or disputes relating to my application for employment, my employment and/or termination of employment with the Company exclusively through the Company's Employment Dispute Resolution Program." Because the claim was related to her employment, the court held that the employee's claim was within the scope of the agreement. Finally, the court examined the agreement's enforceability. The employee argued first that the agreement was unenforceable because she was suing the employer and other individuals for retaliation. The court rejected the employee's argument because when the principal (employer) is bound under the terms of a valid arbitration clause, its agents, employees, and representatives are covered by the agreement. The court thus upheld the agreement as valid.

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LENDING

Court Enforces Standstill Provision in an Intercreditor and Subordination Agreement [NY APP]

The borrower obtained loans from the first priority lender's predecessor and guaranteed repayment of the loans. Then, the borrower executed a promissory note with another party during a business transaction, which resulted in that party becoming the third priority lender to the debtor. The parties also executed an intercreditor and subordination agreement (ICA). A standstill provision in the ICA established that, in the event of the borrower's default, the third priority lender could not pursue remedies against the borrower until the first and second priority lenders had been paid in full. When the borrower later defaulted, the third priority lender perfected its

secured interest on the property of the borrower's guarantor by filing a UCC-1 financing statement. In response, the first priority lender filed a UCC-3 termination statement of the security interest with the Delaware Secretary of State. The third priority lender sued the borrower, the guarantor, and the first priority lender on various grounds, in order to avoid enforcement of the subordination agreement according to its terms. The parties filed cross motions for summary judgment. The trial court denied summary judgment for the third priority lender and granted summary judgment for the borrower, the guarantor, and the first priority lender. The third priority lender appealed.

In Intrepid Invs., LLC v. Selling Source, LLC, N.Y.S.3d, Case No. 2021-03229, 2023 WL 1112401, 2023 N.Y. App. Div. LEXIS 394 (N.Y. App. Div. Jan. 31, 2023) (opinion not yet released for publication), the appellate court affirmed the trial court. The court held the third priority lender's action was barred by the ICA's standstill provision because the first and second priority lenders had not been paid in full. The court upheld the standstill provision's validity, despite any alleged material breaches of the ICA, because the ICA contemplated refinancing and permitted the borrower and the first priority lender to amend their agreements without the third priority lender's consent. In any event, the court found no material breach when the first priority lender terminated the third priority lender's financing statement because the ICA had authorized this action. The third priority lender also argued that the first priority lender materially breached the ICA by breaching the implied covenant of good faith and fair dealing. The court rejected this argument by explaining an implied covenant cannot be used to create terms that do not exist. Ultimately, the court affirmed the motion court's grant of summary judgment against the third priority lender. By Shelbi Stogdill sstogdil@ttu.edu Edited by Peter Benson.

SECURED INTERESTS

Final Order Confirming Sale Required for Safe Harbor in Disposing of Collateral [TX APP]

The debtor entered into three separate guaranty agreements with the creditor. The debtor agreed to be liable as the primary obligator for the payment and performance on the agreements. The debtor failed to make the payments, and the creditor sent a demand letter requiring the debtor to cure the default. Because the debtor failed to cure the default, the creditor sued to recover on the guaranty agreements. The debtor then filed for Chapter 7 bankruptcy. The bankruptcy court authorized the creditor to enforce its rights and remedies, including foreclosure and repossession of the debtor's personal property. After the repossession and collection of the proceeds, the creditor sought damages against the debtor for the remaining balance pursuant to the guaranty agreements. The debtor argued the creditor's collection and disposition of the collateral was not completed in a commercially reasonable manner as required by Chapter 9 of the Texas Business and Commercial Code (Article 9 of the UCC). Additionally, the debtor alleged that the creditor breached its fiduciary duty to the debtor by "using its control over the debtor's business to … steal equipment … and interfere with its customer relationships." The trial court granted summary judgment for the creditor ruling that the creditor was protected by the safe harbor for judicial approval. The debtor appealed.

In Anders v. CrossFirst Bank, Case No. 05- 21-00769-CV, 2022 WL 17750549, 2022 Tex. App. LEXIS 9216 (Tex. App.-Dallas Dec. 19, 2022) (unpublished opinion), the appellate court held the creditor's method of collection and disposition of the collateral was not commercially reasonable as a matter of law. Although the trial court had preapproved the collection, the record did not contain a final order confirming the sale, which undermined the creditor's reliance on the safe harbor for judicial approval. Because the safe harbor was inapplicable, the court found a material issue of fact existed as to the commercial reasonableness of the sale; therefore, the trial court erred in granting summary judgment. In determining whether the creditor had breached its fiduciary duty to the debtor, the court held the creditor contractually waived any fiduciary duty to the debtor in the loan agreement. The court emphasized the importance of honoring the parties' contractual terms, including limitations on fiduciary duties that might otherwise exist. Thus, the court affirmed the judgment in part and reversed in part.

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A Creditor's Pre-Petition Security Interest in Accounts Does Not Extend to Post-Petition Sale Proceeds of Unencumbered Real Estate [BKR SD TX]

A community bank (the bank) loaned the debtor $1.5 million. The bank filed a UCC-1 financing statement perfecting its prepetition liens on the debtor's personal property and the proceeds of that collateral. Later, post-petition, after the debtor had filed for bankruptcy, the court authorized the debtor to sell real estate on which no party had a pre-petition mortgage. The debtor and bank intended the proceeds of this sale to pay off the bank's claims; however, an unsecured creditor objected. The unsecured creditor argued that under § 9-109(d)(11) of the Texas Business and Commerce Code, a perfected security interest only allows for an interest in personal property and does

not apply to real estate. The bank and debtor each argued that the bank had an interest in the money because the sale created an "account" under article 9 of the UCC, and the bank had a perfected prepetition security interest in accounts. The court had to determine whether the proceeds from the sale of the real estate created an "account" subject to the bank's security interest and, if so, whether the Bankruptcy Code would allow the bank any claim over the proceeds.

In In re, Burts Constr., Inc., Case No. 22-31700, 2023 WL 370642, 2023 Bankr. LEXIS 169 (Bankr. S.D. Tex. 2024) (opinion not yet released for publication), the court denied the debtor's motion to pay the bank. The court first had to determine whether the proceeds from the real estate sale constituted an "account" that would be subject to the bank's liens. The court did find that § 9- 102(a)(2) of the Texas Business and Commerce Code allows proceeds from sold property to be included as an "account." Furthermore, the court found that § 9-109(d)(11) did not prevent the banks' liens from extending to the sale proceeds. However, the court ultimately decided that because the sale of the property was post-petition rather than pre-petition, the court had to look to the Bankruptcy Code to see if any additional rules might block the creditor's access to the funds. 11 U.S.C. § 552(a) states that any property acquired after the bankruptcy petition date is not subject to any pre-petition liens. To be sure, 11 U.S.C. § 552(b)(l) allows for an exception if the collateral producing the proceeds was obtained pre-petition. The court explained "if a creditor held a security interest in inventory acquired by the debtor prepetition and proceeds of the inventory, the security interest in proceeds extends to cash generated by a postpetition sale of the inventory." Nonetheless, the court did not find that exception to apply to the facts of this case. The disputed real estate was sold, and the proceeds were acquired, post-petition. The creditor had not had a mortgage on the real estate prepetition. Thus, the proceeds from the sale were not subject to the bank's security interests, and the debtor's motion to pay was denied.

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Choice of Law Governs Whether Security Interest is Perfected [BKR KS]

The debtor bought a vehicle with a New York title. The creditor recorded a Notice of Lien with the Missouri Department of Revenue, but the debtor never retitled the vehicle in Missouri. The debtor later moved to Kansas and filed for a Chapter 7 bankruptcy petition in the District of Kansas and surrendered the vehicle along with the New York title to the creditor. The creditor then moved for stay relief under 11 U.S.C § 362(d) to exercise its rights against the vehicle. The Chapter 7 trustee objected because the creditor's security interest in the vehicle might not have been perfected at the time the debtor filed for bankruptcy.

In In re Nazarenko, No. 21-20533, 2023 Bankr. LEXIS 166 (Bankr. D. Kan. Jan. 18, 2023), the court held that the creditor's security interest in the vehicle was unperfected under the local law of New York (applied here via Kansas choice-of-law rules) at the time the debtor filed for Chapter 7 bankruptcy. Section 84-9-303(c) of the Kansas statute (which tracks the Uniform Commercial Code) provides that the "local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or non-perfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title." Thus, the law of the issuing jurisdiction governs perfection and priority from the time the certificate is issued until the vehicle is no longer covered by that certificate of title. Based on Kansas choice-of-law rules, New York law therefore governed. Because New York law provides that the rights of a lien creditor are superior to the rights of an entity with an unperfected security interest, and the Chapter 7 trustee has the rights of a lien creditor, the court held that the security interest of the debtor was both unperfected and subordinate to the rights of the Chapter 7 trustee. Accordingly, (1) the creditor's motion for stay relief under 11 U.S.C. § 362(d) was denied, and (2) the Chapter 7 trustee proceeded with an action to avoid the creditor's unperfected security interest under 11 U.S.C. § 544.

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Subcontractor Defaults; Bank's Security Interest Prevails Over Surety's Interest [VA]

A subcontractor (debtor) obtained a line of credit from a bank to fund job contracts that were not subject to surety bonds. The debtor was required to open four accounts with the bank and grant the bank a perfected security interest in all the debtor's deposit accounts. Further, the bank could set off, appropriate, seize, and freeze all items, without notice to the debtor, in the event of default. The debtor also obtained three payment and performance surety bonds from a surety company. The debtor and the surety signed a General Indemnity Agreement (GIA) that gave the surety all rights over the debtor and indemnitors in the event of default. The bank was not a party to this agreement as an indemnitor. Over a one-year period, the debtor defaulted twice on its obligations to the bank, and once on its obligations to the surety. The surety requested that the debtor create a trust account for its bonded project receivables separate from

the bank. The debtor never opened a separate trust account. Shortly thereafter, the bank froze all of debtor's accounts and took roughly $2,500,000 to pay down the debtor's outstanding loan balances with the bank. The bank did not allow the surety to claim any funds to cover its loss from the debtor's default. The debtor and surety sued the bank for conversion and unjust enrichment.

In Arch Ins. Co. v. FVCbank, 88l S.E.2d 785 (Va. 2022), the court ruled the bank's interest in the debtor's accounts was superior to the surety's claims. The court first found that the bank maintained a perfected security interest in the debtor's deposit accounts under the UCC as adopted under Virginia state law. Further, the court noted that because the debtor deposited its bonded project receivables into an account at the bank, the bank had a claim over those funds before the surety. Next, the court considered the surety's interest in the debtor's deposit accounts. It found that the surety did not have a perfected security interest in the accounts because it did not have "control" of the accounts, which is necessary for perfection in a deposit account under the U.C.C. However, under the GIA, the surety did acquire an equitable interest through subrogation. The subrogation right merely allowed the surety to step into the debtor's place and use all the rights available to the debtor, some of which had already been signed away to the bank. Finally, the court determined whether the bank's perfected security interest or the surety's equitable interest in the deposit accounts had priority. Va. Code Ann.§ 8.9A- 327 (2022) states that a security interest of a secured party holding control of a deposit account has priority over another party that does not possess control of the deposit account. Because the debtor never put the bonded project funds into a separate trust account, the surety lacked control of the bonded funds in the deposit account at the bank. The court found no evidence of conversion or unjust enrichment and found that the bank possessed the superior claim to the debtor's deposit accounts.

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Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

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